

**MINUTES
REGULAR MEETING
ARIZONA STATE RETIREMENT SYSTEM BOARD**

**Friday, April 15, 2005
8:30 a.m., MST**

The Arizona State Retirement System (ASRS) Board met in the 10th Floor Board Room, 3300 N. Central Avenue, Phoenix, Arizona. Dr. Keith Meredith, Chair of the ASRS Board, called the meeting to order at 8:30 a.m., MST.

The meeting was teleconferenced to the ASRS office at 7660 E. Broadway, Tucson, Arizona 85710.

1. Call to Order; Roll Call; Opening Remarks

Present: Dr. Keith Meredith, Chair
Mr. Karl Polen, Vice Chair
Mr. David Byers
Mr. Jaime Gutierrez
Mr. Chris Harris
Mr. Michael Townsend
Mr. Lawrence Trachtenberg
Mr. Steven Zeman (via teleconference)

Absent: Ms. Anne Mariucci

A quorum was present for the purpose of conducting business.

2. Approval of the Consent Agenda

Motion: Mr. Karl Polen moved to approve Refunds, Death Benefits and Retirements,

And

Approve the System Transfers,

And

Approve the application and agreement with the following employer:

- White Mountain Summer Home Water Improvement District

And

Approve the minutes of the March 9, 2005 Special Meeting, March 9, 2005 Executive Session and March 18, 2005 Regular Meeting of the ASRS Board.

And

Approve the Notice of Rulemaking Docket Opening for Public Participation in Rulemaking

Mr. Michael Townsend seconded the motion.

By a vote of 8 in favor, 0 opposed, 0 abstentions, and 1 excused, the motion was approved.

3. Presentation, Discussion, and Appropriate Action Regarding Board Trustees' Fiduciary Responsibility

Mr. Matson stated that Fiduciary education for ASRS trustees is required by the ASRS Board Governance Handbook. He voiced that the purpose of this education is to strengthen the Trustees' understanding of their roles and responsibilities as an ASRS Trustee.

Mr. Matson stated that this agenda item was an educational session for Trustees and no action was required. He then introduced Mr. Douglas R. McClintock, of Mercer Human Resource Consulting, to present an instructional program on the fiduciary responsibilities of Trustees of a public pension plan.

Mr. McClintock provided a comprehensive, in-depth presentation on ASRS Board Member Responsibility. He indicated that the core duties are: (1) prudence; (2) loyalty; and (3) care, and that other duties stem from the core. Mr. McClintock voiced that the duty of prudence was the most important, and it evolved from the "Prudent Man" standard which focused primarily on capital preservation.

It was further emphasized by Mr. McClintock that the Trustees would be judged by the care, skill, prudence and diligence under the circumstances *then* prevailing that a prudent (expert) (person) acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of like character and with like aims.

Mr. McClintock explained the variances in fiduciary latitude and detailed the duties of loyalty, and care. He indicated that responsibility may be delegated; however, there should be clear, written policies with written performance criteria and annual evaluations.

Mr. McClintock reviewed hypothetical case studies pointing out fiduciary issues, and a discussion ensued. There was review of fiduciary liability/personal liability, financial and reputational consequences, as well as the long-term effects on an organization.

There was a review of the avoidance of liability, and Mr. McClintock stepped through the areas of oversight. He offered practical advice; i.e. have ethics and conflicts of interest policies in place for guidance, self-monitoring and evaluation, and have an annual "booster shot" on fiduciary responsibility – which they were currently undertaking.

At the conclusion of his presentation, Mr. McClintock stated if there were specific questions for legal advice that they should be addressed to Mr. Tom McClory, the Assistant Attorney General.

There was a discussion by the Trustees, with agreement by all, that the presentation was timely and beneficial for the newer Trustees, and was a helpful refresher for the others. Mr. Gutierrez recommended, and there was concurrence, that copies of the presentation be sent to all Trustees and preserved by the ASRS for historical purposes. Staff was instructed to comply with the request of the Trustees.

4. Presentation, Discussion and Appropriate Action With Respect to Funding Methods Available, Pro Forma Analysis, Assumptions and Recommendations Related to the Actuarial Options and Accounting of the LTD Program

Mr. Matson stated that the purpose of the presentation was four-fold. Namely to:

- Present the Trustees with the results of Mercer's analysis of Long Term Disability (LTD) funding and accounting methods that were at issue in Milliman's actuarial audit of the ASRS LTD program.
- Present a re-calculated 2004 actuarial summary using both the Projected Unit Credit (PUC) and Entry Age Normal (EAN) methods.
- Present the LTD contribution rates projections under the PUC and Aggregate methods, prepared by Mellon, ASRS' current actuary.
- Present recommendations from the ASRS staff regarding a possible course of action in light of Mercer's findings and Mellon's analysis.

Mr. Matson introduced Mr. Chris Marshall, Mercer Human Resource Consulting (Mercer), to make a presentation. Mr. Marshall reported that Mercer had been retained to review several funding methodologies for the ASRS LTD Plan. He stated that the scope of the review was not to make a recommendation for a particular methodology, but instead to list the strengths/weaknesses or characteristics of several methodologies and provide the ASRS with strategic insight about the methodologies reviewed.

Mr. Marshall provided an overview of Mercer's analysis of the current ASRS method, detailing the potential advantages and disadvantages. He also reviewed the funding approach suggested by Milliman in their Actuarial Report of the ASRS's LTD Plan dated September 17, 2004.

Mr. Marshall next provided an analysis of GASB 43 Methods, under which there would be an Annual Required Contribution (ARC) each year that the ASRS must calculate and disclose.

Mr. Marshall stated that from a practical perspective, Mercer would recommend that the ASRS investigate the adequacy of the current contribution rates before deciding upon a method, as this could be essential to understanding what will happen to the contribution rates in the future.

Mr. Charlie Chittenden, Actuary, Mellon Human Resources and Investor Solutions, next made a presentation on the effect of GASB 43 on the Valuation of the ASRS LTD Program as of June

30, 2004. He stated that the report determined the ARC amounts and funded status that would apply to the ASRS LTD based on the assets and liabilities of that program as of June 30, 2004.

Mr. Chittenden stated that GASB 43 allowed several alternative methods and assumptions to be used, and the ASRS staff had selected the actuarial cost method, asset valuation method, actuarial assumptions, amortization method and amortization period for this study. He next discussed the table showing the valuation results.

Mr. Chittenden concluded by presenting ten-year forecasts of these contribution rates and funded status percentages, with varying investment return experience, as an aid in choosing the actuarial cost method and amortization period.

Motion: Mr. Michael Townsend moved that:

- The ASRS should align its funding method with one of the acceptable cost methods under Governmental Accounting Standards Board Statement No. 43 (GASB #43).
- The ASRS should commence implementation of a Governmental Accounting Standards Board Statement No. 43 (GASB#43) method on July 1, 2005.
- The ASRS should adopt the PUC method for LTD valuations – the same method it uses for the valuation of the Plan.
- The ASRS should determine the actuarial value of LTD assets using a prospective 10-year asset smoothing procedure, in the same way that it determines the actuarial value of Plan assets.
- The ASRS should use a rolling 15-year period for the amortization of the unfunded actuarial accrued liabilities period of the LTD program.

Mr. Jaime Gutierrez seconded the motion.

By a vote of 8 in favor, 0 opposed, 0 abstentions and 1 excused, the motion was approved.

5. Presentation, Discussion and Appropriate Action With Respect to Arizona's Open Meeting Law

Mr. Matson voiced that this presentation was for informational purposes and no action was required by the Board.

Mr. Matson next introduced Mr. Tom McClory, Assistant Attorney General, to provide a brief overview of the Arizona Open Meeting Law (OML) as it relates to the ASRS Trustees and usage of e-mails.

Mr. McClory stated that the OML was first adopted in Arizona in 1962, and extensively amended in 2000. He indicated that the intent of the OML was to maximize public access to the governmental process, and the provisions of the OML apply to all public bodies, including the ASRS Board.

Mr. McClory provided an overview of the policy of the OML, citing that it is driven by two core concepts: (1) the Legislature mandated that “[a]ll meetings of any public body shall be public meetings and all persons so desiring shall be permitted to attend and listen to the deliberations and proceedings;” and (2) the Legislature established the following public policy in this State: that “meetings of public bodies be conducted openly and that notices and agendas be provided for such meetings which contain such information as is reasonably necessary to inform the public of the matters to be discussed or decided.”

Mr. McClory next detailed OML Notices to be given, the Agenda content and the Executive Session. He stated that a lawsuit to enforce the OML can be initiated by the Attorney General, County Attorneys and any interested person regarding compliance with the Law, and it is always best to err in favor of open meetings.

6. Presentation, Discussion and Appropriate Action Regarding the ASRS International Equity Manager Review

Mr. Lawrence Trachtenberg, Investment Committee (IC) Chair, stated that a presentation would be made on the ASRS International Equity Managers. The Investment Committee is currently conducting a complete review of this asset class with respect to the active/passive mix, the ASRS emerging growth exposure, cap size of investments and benchmarking.

Mr. Gary Dokes, Chief Investment Officer, reported that he and Terry Dennison, Principal, Mercer Investment Consulting, will be providing an annual presentation regarding ASRS’ International Equity Managers. He indicated the presentation was for informational purposes and no Board action was required.

Mr. Dokes stated that also present, via teleconference, were ASRS’ three external managers who were ready to answer any questions that the Trustees might have. The following Equity Managers introduced themselves:

- Ian Sunder, Institutional Portfolio Manager, Brandes
- David Lissek, Principal, Client Relationship Officer, Barclays Global Investors (BGI)
- Kurt Zyla, Vice President, Bank of New York

Mr. Dokes reviewed the International Equity Assets, as of December 31, 2004, reporting that the Assets had a market value of \$3.6 billion, or about 16% of the ASRS assets.

The International Equity Manager Mandates were discussed, and it was noted that:

- Brandes outperformed its benchmark and placed in the top quartile of the universe for all periods evaluated. Mercer rated this product A- (which is an above average probability of outperformance.) There are no organizational concerns at this time.
- Bank of New York underperformed its benchmark for all periods evaluated except five years and since inception, and Mercer does not rate this product. There are no organizational concerns at this time.

- BGI has tracked its benchmark closely for all periods, and Mercer does not rate this product. There are no organizational concerns at this time.

7. Presentation, Discussion and Appropriate Action Regarding State Legislation for the 2005 Legislative Session Relating to the ASRS.

Mr. Matson requested Ms. Denisse Gee, Government Relations Officer, to provide an overview to the ASRS Board. Ms. Gee referred to the April 8, 2005 iteration of the "Quick Reference" guide.

The Board heard a presentation by Ms. Gee regarding various bills that might impact the ASRS. The following bills were discussed:

HB2472, HB2473, HB2474, HB2552, HB2562, HB2621, HB2641, HB2718, SB1014, SB1186, SB1206, SB1278, SB1359 and 1360, SB1366, SB1426 and SB1428.

8. Director's Report

Mr. Paul Matson highlighted the reversal in error rates for service purchase cost invoices and other financial services backlog that the agency had been experiencing. He indicated that service still needs to be monitored; however, he reported that headway was being made and the agency has reversed the negative. Mr. Matson stated that enhanced monitoring would be ongoing until June, but that the trajectory seems good.

9. Possible Presentation and Discussion Regarding Board Committee Updates

Mr. Jaime Gutierrez, Chair, External Affairs Committee, reported that there would be more rulemaking presented at a future meeting

Mr. Lawrence Trachtenberg, Chair, Investment Committee, reported that more Asset Manager calls are being scheduled and interviews are being conducted for a Real Estate Manager.

Mr. Michael Townsend, Chair, Operations Committee, reported that at the March Operations Committee Meeting staff gave an update on the agency's Financial Services Division, Call Center and Service Purchase Programs. Staff will be making a presentation on these and other service issues at the May Board Meeting.

10. Board Requests for Agenda Items

Dr. Keith Meredith called for Board Requests for Agenda Items. There were no requests made.

11. Call to the Public

Dr. Keith Meredith recognized Dr. Bob Letson, a retired member, who was participating telephonically from the Tucson office.

Dr. Letson stated that he was Professor Emeritus from the University of Arizona and that May of last year, he had attended a meeting of the External Affairs Committee (EAC) and was

particularly interested in the area of SB 1426, Spousal Consent. Dr. Letson indicated there was strong support for the bill by the University of Arizona Retirees Association, and he was inquiring if the bill was discussed by the EAC. Mr. Jaime Gutierrez responded that SB 1426 was discussed at the meeting.

Dr. Letson suggested that perhaps there could be more transparency with the agency by posting additional information to the ASRS Website, e.g. by posting Committee minutes, along with the Board meeting minutes that are already being posted.

After discussion, Mr. Paul Matson stated that there would be a follow-up to the issue of posting information.

12. Presentation, Discussion and Appropriate Action with Respect to the 2004 Review of the Director of ASRS

Motion: Mr. Steven Zeman moved that the Trustees convene to executive session to consider the performance of the Director, which would not be open to the public.

Mr. Michael Townsend seconded the motion.

By a vote of 8 in favor, 0 opposed, 0 abstentions, and 1 excused, the motion was approved.

The Trustees adjourned to Executive Session at 11:10 a.m.

The Trustees reconvened to the public meeting at 12:08 p.m.

Motion: Mr. Lawrence Trachtenberg moved that in light of the Director's continued excellent performance after completing more than two years in his position, the Director's salary be raised to the top of the E6 pay scale.

Mr. Karl Polen seconded the motion.

By a vote of 8 in favor, 0 opposed, 0 abstentions, and 1 excused, the motion was approved.

Motion: Mr. Karl Polen moved that staff be directed to explore ways so that at next year's review, the Trustees have more latitude with a pay increase for the Director.

Mr. Lawrence Trachtenberg seconded the motion.

By a vote of 8 in favor, 0 opposed, 0 abstentions, and 1 excused, the motion was approved.

Dr. Keith Meredith stated that he was impressed that the Director had developed the "outside face" with the State and the Governor's office, as well as establishing better communication channels.

Mr. Michael Townsend thanked Mr. Matson for his assistance with some of the investment issues. He, also, stated that Mr. Matson's motivational skills are excellent.

Mr. Karl Polen stated that Mr. Matson's job was "well done." He voiced that over the past couple of years, Mr. Matson had made a smooth transition and the agency is better off for the work that has been accomplished. Mr. Polen stated that he had nothing but the utmost respect for Mr. Matson and his role has put a face to the ASRS, which has been commendable.

Mr. Jaime Gutierrez stated that he had been a Trustee for little over a year and that he was pleased with Mr. Matson's performance. Mr. Gutierrez voiced that it had been a difficult and different legislative session and that Mr. Matson had remained positive and handled it well.

Mr. Dave Byers stated that he was one of the newer Trustees, but was very impressed with Mr. Matson and his staff in that they had been very open and actively pursued correcting various situations.

Dr. Keith Meredith stated that he would be meeting individually with Mr. Matson to discuss the comments.

Mr. Paul Matson thanked everyone for enabling the agency and supporting him and other management staff as they performed their jobs.

13. The next ASRS Board meeting is scheduled for Friday, May 20, 2005 at 8:30 a.m., at 3300 N. Central Avenue, 10th Floor Board room, Phoenix, Arizona.

14 Adjournment of the ASRS Board

Dr. Meredith adjourned the April 15, 2005 Board meeting at 12:21 p.m.

ARIZONA STATE RETIREMENT SYSTEM

Cassandra Harris, Secretary

Date

Paul Matson, Director

Date